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NSC FOR CBARTON
ENERGY FOR DPUMPHREY AND ALOCKWOOD

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TAGS: [ENRG](#) [PGOV](#) [VE](#)
SUBJECT: VENEZUELA: CONOCOPHILLIPS - BACK IN THE GAME?

Classified By: Economic Counselor Richard Sanders; for reasons 1.4 (b)
and (d)

SUMMARY

11. (C) On January 12, a report hit the international news wires that ConocoPhillips, the single largest foreign investor in Venezuela, would pull out following the breakdown in its negotiations with the GOV on the development of the Corocoro offshore oil field. By week's end, ConocoPhillips and the GOV had resumed negotiations - but only after the company CEO had agreed to waive any rights to litigate on the issue of the royalty increase previously levied on the Orinoco extra heavy crude projects by the GOV. (Of the other two major U.S. oil companies in Venezuela, ExxonMobil and ChevronTexaco, the former is going to litigate against the royalties increase, while the latter is going along with it.) However, it remains unclear if ConocoPhillips will be able to bring the Corocoro project to fruition. End summary.

PRESS REPORTS CONOCOPHILLIPS TO PULL OUT

12. (U) On January 12, a report hit the international news wires that ConocoPhillips would be leaving Venezuela following the breakdown in its negotiations with the GOV on the development of the Corocoro oil field. These stories drew on public comments made by Energy Minister Rafael Ramirez on January 11 in which he said that ConocoPhillips would not begin drilling in Corocoro anytime soon because of problems with the Company's proposed investment plan. The wire stories also drew on a January 11 report by "Descifrado," a Venezuelan web-based newsletter, which alleged that ConocoPhillips had been ordered to leave due to President Chavez's anger over public comments made by a senior company executive.

BACKGROUND

13. (C) The Corocoro field is located in the shallow waters of the Gulf of Paria near Trinidad. It is one of the few early hopes for an increase in Venezuelan oil production. The field was discovered as the result of a profit-sharing agreement inked with then-Conoco in 1996. ConocoPhillips declared commerciality on the field in 2002 and the Ministry of Energy and Mines approved its development plan in 2003. Despite this, contentious negotiations with the GOV over meeting national content requirements for goods and services related to the field's development have delayed the project. ConocoPhillips executives informed emboffs in 2004 that changing GOV national content requirements would add significantly to the cost of the project. The plan called for field production of 70,000 b/d to start in 2006. ConocoPhillips executives confirmed to econoff in late 2004 that delays in the development of the project would likely push first production back to 2007.

CONOCOPHILLIPS SCRAMBLES

14. (C) Early on January 12, econoff contacted ConocoPhillips de Venezuela President John Hennon for a readout on the press reports. Hennon reported that he had last met with PDVSA officials on December 17 and that he believed at that time that there had been agreement on the last outstanding element of the investment plan. However, when this agreement was subsequently taken before the PDVSA Board, said Hennon, it was vetoed by Energy Minister/PDVSA President Ramirez and Exploration and Production Vice President Felix Rodriguez. Hennon said that Ramirez and Rodriguez were reportedly very angry that ConocoPhillips had sent a letter to PDVSA reserving its rights to take legal action with respect to the royalty increase on the Orinoco extra heavy crude projects.

(Note: ConocoPhillips has multi-billion dollar investments in two of the four extra heavy crude projects, i.e., Petrozuata and Hamaca. The Hamaca project came on line in

October and thus never had the benefits of the low 1.0 pct royalty enjoyed by the other three projects.) Hennon was concerned because he had received a call from an "aide to the Minister" the night before who said that President Chavez had directed that the GOV break relations with ConocoPhillips and that the company should leave Venezuela.

15. (C) Late in the day on January 12, Hennon informed econoff that ConocoPhillips Chairman Mulva had flown to Washington for a meeting with Venezuelan Ambassador Bernardo Alvarez. Alvarez, said Hennon, had told Mulva that there would be no further dialogue with ConocoPhillips unless the company rescinded the notice it had given PDVSA reserving its rights to litigate on the royalty issue. Mulva elected to waive any rights going forward and on that basis Alvarez said the door was now open again for dialogue. On January 13, Hennon confirmed that a senior corporate executive had talked with Vice Minister Vierma and that negotiations had resumed.

COMMENT

16. (C) Ultimately, much of the trade press has cast this episode as an investment dispute, claiming that when ConocoPhillips sought to defer part of the investment it had agreed to in 2003, the GOV reacted because it wants the cash. While there may be an element of truth there, we believe that is only part of the story. Hennon told us that the GOV had had the investment numbers since September and that they had not become a significant problem until the royalty issue blew up. So it may indeed be the case that senior GOV officials - and particularly President Chavez - did react with anger to certain comments made to the press about the royalty issue by a senior ConocoPhillips executive reiterating that the hike had violated the firm's contractual rights. By now waiving them, ConocoPhillips has put itself in line with the position of ChevronTexaco, which had never asserted them. Exxonmobil, however, appears to be ready to try to take the GOV to international arbitration over the issue, septel.) However, it is possible that ConocoPhillips' retreat, made late in the day, may not be sufficient to allow it to bring the Corocoro project to fruition.
McFarland

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